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REBUTTAL TESTIMONY OF
SCOTT WILSON
ON BEHALF OF
SOUTH CAROLINA ELECTRIC & GAS COMPANY
DOCKET NO. 2009-261-E

**Q. ARE YOU THE SAME SCOTT WILSON THAT HAS PREFILED
DIRECT TESTIMONY IN THIS CASE?**

A. Yes, I am.

**Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL
TESTIMONY?**

The purpose of my testimony is to respond to portions of the direct testimony of Dr. William Steinhurst, who is testifying on behalf of the Southern Environmental Law Center and the South Carolina Coastal Conservation League; Randy Gunn, who is testifying on behalf of the South Carolina Office of Regulatory Staff; Kevin W. O'Donnell, who is testifying on behalf of the South Carolina Energy Users Committee; and Dr. Dennis W. Goins, who is testifying on behalf of CMC Steel South Carolina. Specifically, I will be responding to the testimony of each of these witnesses with respect to SCE&G's proposal for an incentive associated with its costs of implementing its demand-side management

1 ("DSM") programs through a 3% adder to the return on equity ("ROE")
2 applicable to SCE&G's DSM programs.

3

4 **Q. HAVE YOU REVIEWED THE DIRECT TESTIMONY OF DR.**
5 **STEINHURST, MR. GUNN, MR. O'DONNELL, AND DR.**
6 **GOINS?**

7 A. Yes, I have.

8

9 **Q. FIRST, I WANT TO ASK YOU TO ADDRESS THE DIRECT**
10 **TESTIMONY OF DR. STEINHURST AS IT PERTAINS TO THE**
11 **3% ROE ADDER. DOES DR. STEINHURST COMPLETELY**
12 **REJECT THE USE OF THE ROE ADDER?**

13 A. No, not at all. In fact, Dr. Steinhurst readily concedes on Page 24,
14 Lines 14-18, that a ROE adder like that proposed by SCE&G is a
15 reasonable incentive structure and that a ROE adder "can be an effective
16 utility incentive mechanism."

17

1 **Q. DESPITE ACCEPTING THE ROE ADDER AS PART OF A DSM**
2 **PROGRAM, DR. STEINHURST GOES ON TO OPINE AGAINST**
3 **THE 3% ROE ADDER AS PROPOSED BY SCE&G, STATING**
4 **THAT THE ROE ADDER SHOULD BE TIED TO**
5 **PERFORMANCE. HOW DO YOU RESPOND TO HIS**
6 **TESTIMONY?**

7 A. I disagree with Dr. Steinhurst. As I stated in my direct testimony,
8 SCE&G's incentive proposal is fair, transparent, easily understood, and
9 consistent with South Carolina Code Section 58-37-20 because it
10 provides for an additional 3% return on the most recently approved ROE
11 as applied to the easily-identified investments by SCE&G in its DSM
12 programs. In contrast, tying the collection of an incentive payment to
13 actual savings performance would inject a significant measure of
14 uncertainty into the determination and collection of the incentive ROE
15 addor. This uncertainty would arise because the measurement and
16 attainment of performance standards often are subject to significant
17 dispute in after-the-fact proceedings designed to determine incentives
18 "earned" by a particular utility. While in theory incentives tied to
19 performance have some appeal, in practice they increase the uncertainty
20 around the ultimate collection of an incentive and increase the costs of
21 implementing an effective DSM program. SCE&G's program proposal

1 to invest in cost effective DSM programs provides an incentive that is
2 reasonable, easy to determine and easy to monitor.

3
4 **Q. DR. STEINHURST ALSO SUGGESTS A RANGE FOR THE ROE**
5 **INCENTIVE THAT POTENTIALLY COULD INCLUDE A**
6 **NEGATIVE ADJUSTMENT TO ROE. DO YOU BELIEVE THAT**
7 **DR. STEINHURST’S SUGGESTION IS CONSISTENT WITH**
8 **SOUTH CAROLINA CODE SECTION 58-37-20?**

9 A. No. South Carolina Code Section 58-37-20 requires that any
10 Commission program mandating an electric utility like SCE&G to
11 “invest in cost-effective energy efficient technologies and energy
12 conservation programs” also must allow an electric utility making these
13 investments “to recover costs and obtain a reasonable rate of return on
14 their investment in qualified demand-side management programs
15 sufficient to make these programs at least as financially attractive as
16 construction of new generating facilities” and “ensure that the net
17 income” of an electric utility “after implementation of specific cost-
18 effective energy conservation measures is at least as high as the net
19 income would have been if the energy conservation measures had not
20 been implemented.” DSM programs that include a negative ROE
21 adjustment would earn a return at a level below that for supply-side

1 investment and cannot comply with these conditions as expressed in the
2 statute.

3
4 **Q. ASIDE FROM THE PROBLEMS WITH ANY NEGATIVE**
5 **ADJUSTMENT, ARE THERE OTHER CONCERNS YOU HAVE**
6 **WITH THE INCENTIVE STRUCTURE SUGGESTED BY DR.**
7 **STEINHURST?**

8 A. Yes. Dr. Steinhurst's suggestion to connect the incentive ROE
9 adder to the achievement of annual DSM energy savings targets simply
10 sweeps aside issues arising from the need to objectively determine the
11 actual savings from the DSM programs. He in fact notes on page 22 of
12 his testimony that "DSM programs require specialized monitoring,
13 verification, and evaluation (MV&E) for several reasons. Good MV&E
14 is needed to ensure (1) sound design and delivery of programs, including
15 continuous improvement, (2) accurate determination of lost revenue
16 adjustments, (3) accurate administration of any utility incentive
17 mechanism, and (4) support for program cost recovery." He goes on to
18 state that due "to the variety of measures and programs, these activities
19 are more complex than supply-side measures." In short, Dr. Steinhurst
20 implicitly recognizes the measurement problems and additional costs
21 associated with implementing and administering DSM programs,
22 including the "accurate administration of any utility incentive

1 mechanism.” SCE&G is seeking, among other things, to reduce a portion
2 of these additional DSM-related administrative costs via its incentive
3 ROE adder provision, which encourages SCE&G to rollout cost effective
4 DSM programs without imposing unnecessary costs and injecting
5 unnecessary uncertainties relative to earning the investment incentive.
6

7 **Q. DR. STEINHURST, ALONG WITH OTHER WITNESSES,**
8 **SUGGESTS THAT THE 3% ROE ADDER IS TOO HIGH. DO**
9 **YOU AGREE WITH THAT SUGGESTION?**

10 A. No. The 3% adder proposed by SCE&G is below the incentive
11 adder approved in Nevada but is higher than the 1% adder suggested by
12 other witnesses in this case. At 3%, the adder is high enough to serve as
13 a reasonable incentive for the Company to invest in DSM programs
14 without effectively penalizing the Company for making investments in
15 DSM programs versus physical generation facilities.
16

1 **Q. YOU HAVE EXPRESSED CONCERN OVER THE INCREASED**
2 **RISKS OF DSM PROGRAMS, BUT DR. STEINHURST STATES**
3 **THAT UTILITIES GENERALLY DO NOT COMPARE THE**
4 **RISKS AND UNCERTAINTY OF DSM INVESTMENTS TO**
5 **THOSE OF GENERATION ASSETS, AND CITES TO YOUR**
6 **TESTIMONY AS AN EXAMPLE OF THIS. WHAT IS YOUR**
7 **RESPONSE TO HIS STATEMENT?**

8 A. I disagree with Dr. Steinhurst because utilities, as part of their
9 planning process, do compare the risk and uncertainty of DSM
10 investments to those of generation assets. DSM and supply-side asset
11 investment risks and uncertainties do share some similarities, such as
12 cost recovery and operating risk; i.e., determining whether DSM
13 produces the expected savings, or whether power plants are operating as
14 planned. DSM programs include risks that supply-side investments do
15 not have. For instance, DSM programs erode sales of the utility's
16 principal product, which is the source of an investor's expected return.
17 DSM programs generally require the creation of regulatory assets, which
18 are subject to valuation disputes and statutory changes and, thus, are
19 viewed less favorably by investors than hard assets. Also, as I stated in
20 my direct testimony, should the regulatory asset account on the balance
21 sheet become too large, it may become a concern to rating agencies and
22 adversely impact bond ratings, which constitute an additional risk to

1 investors, especially to bond investors, who are seeking relatively safer
2 returns than equity investors. Therefore, DSM programs carry risks and
3 uncertainties not usually associated with supply-side assets.

4 Also, as Dr. Steinhurst notes, I do believe that the Company's
5 proposal serves to mitigate investor risks accompanying DSM program
6 investments—but only if the 3% adder is maintained as proposed, not as
7 diluted by Dr. Steinhurst's proposal to connect the adder to performance.
8 Importantly, I believe the adoption of Dr. Steinhurst's proposal of a
9 potential negative ROE adjustment not only would be inconsistent with
10 the statutory mandate, but also would increase the utility's risk from the
11 DSM programs.

12
13 **Q. WHAT IS YOUR RESPONSE TO DR. STEINHURST'S**
14 **STATEMENT THAT BASING THE INCENTIVE ON**
15 **EXPENDITURES RESULTS IN AN INCENTIVE TO INFLATE**
16 **THE COST OF ACQUIRING A RESOURCE?**

17 A. In my opinion, Dr. Steinhurst overstates this risk while
18 understating the problems that will arise from imposing savings targets
19 that are not easily susceptible to objective determination. Certainly, there
20 is no evidence that SCE&G will inflate the costs of its DSM
21 investments. Furthermore, the annual review conducted by this
22 Commission with input from ORS and interested parties will mitigate

1 any risk of inflating the cost of the DSM assets. In contrast, it is beyond
2 serious doubt that disputes would arise from the measurement of actual
3 savings versus savings targets, disputes that only could be resolved
4 through substantial and costly proceedings before this Commission.

5

6 **Q. NEXT PLEASE FOCUS YOUR ATTENTION UPON THE**
7 **TESTIMONY OF RANDY GUNN, WHO SUGGESTS THAT THE**
8 **INCENTIVE SHOULD BE ADDED TO THE COMPANY'S**
9 **TOTAL RATE OF RETURN AND SCALED BASED ON THE**
10 **ACTUAL ENERGY SAVINGS OF THE DSM PROGRAMS.**
11 **WHAT IS YOUR RESPONSE TO THIS TESTIMONY?**

12 A. Although Mr. Gunn's suggestion of a 1% minimum adder is
13 preferable to Dr. Steinhurst's suggestion that a return on equity penalty
14 could be appropriate, I disagree with Mr. Gunn's proposal to tie the level
15 of the adder to actual savings for the reasons explained above in
16 response to Dr. Steinhurst's testimony.

17

1 **Q. AND WHAT IS YOUR RESPONSE TO MR. GUNN'S**
2 **SUGGESTION TO ADD THE INCENTIVE TO THE**
3 **COMPANY'S TOTAL RATE OF RETURN RATHER THAN THE**
4 **COMPANY'S RETURN ON EQUITY?**

5 A. Aside from the problems with the performance requirement, I
6 believe that the Company's proposal to add the incentive to ROE is a
7 more transparent approach for investors to assess the impact of DSM
8 investments on SCE&G. Moreover, if Mr. Gunn's recommendation is to
9 add an incentive to the Company's total rate of return and apply that
10 return to all components of the capital invested in DSM programs, that
11 would be an acceptable method of providing the Company with an
12 incentive to invest in DSM programs so long as the incentive is not
13 connected to actual savings performance. If, however, Mr. Gunn's
14 recommendation would result in a lower incentive than that proposed by
15 the Company, then SCE&G would strongly object.

16

17

1 **Q. NEXT, I WANT YOU TO DISCUSS THE TESTIMONY OF**
2 **KEVIN O'DONNELL. MR. O'DONNELL STATES THAT SOUTH**
3 **CAROLINA CODE SECTION 58-37-20 DOES NOT ALLOW**
4 **SCE&G TO EARN AN INCENTIVE ON DSM PROGRAM**
5 **INVESTMENTS ABOVE THE APPROVED RETURN ON**
6 **EQUITY. WHAT IS YOUR RESPONSE TO THAT STATEMENT?**

7 **A.** I disagree with Mr. O'Donnell's statement. Section 58-37-20
8 requires in pertinent part that any DSM programs approved by the
9 Commission must

- 10 • provide incentives and cost recovery for electric utilities that
11 invest in "energy supply and end-use technologies that are cost-
12 effective, environmentally acceptable, and reduce energy
13 consumption or demand"; and
- 14 • allow electric utilities making these investments "to recover costs
15 and obtain a reasonable rate of return on their investment in
16 qualified demand-side management programs sufficient to make
17 these programs at least as financially attractive as construction of
18 new generating facilities."

19 Thus, the statute specifically mandates incentives for electric utilities to
20 invest in DSM programs. Moreover, without the ROE adder as an
21 incentive for an electric utility to make these investments, the DSM
22 programs would not be "as financially attractive as construction of new

1 generating facilities.” As I have testified elsewhere, an effective DSM
2 program among other things reduces an electric utility’s need to invest in
3 traditional electric utility assets, which are the source of its return under
4 traditional rate-making procedures like those employed by SCE&G. The
5 ROE adder can partially mitigate the Company’s lost revenue stream
6 from foregone investment while also providing an incentive for the
7 Company to pursue aggressively DSM programs. Therefore, in my
8 opinion, the ROE adder proposed by SCE&G is allowed by Section
9 58-37-20 because incentives should make the investment in DSM
10 programs at least as financially attractive as the construction of new
11 generating facilities.

12
13 **Q. MR. O’DONNELL ALSO STATES THAT HE DOES NOT**
14 **BELIEVE “THE COMMISSION SHOULD GRANT SCE&G AN**
15 **EXCESSIVE RETURN ON EQUITY WITHOUT SETTING**
16 **SPECIFIC BENCHMARK GOALS FOR THE UTILITY.” WHAT**
17 **IS YOUR RESPONSE TO THIS STATEMENT?**

18 **A.** I disagree with Mr. O’Donnell’s statement, except to the extent
19 that, despite his earlier statement, he seems to accept that some ROE
20 incentive may be acceptable under certain circumstances. I should also
21 point out my disagreement with the suggestion that the ROE adder is an
22 excessive return because, as I explained above, the adder is an

1 appropriate mechanism for complying with the statutory mandate of
2 Section 58-37-20.

3
4 **Q. FINALLY, I WANT YOU TO DISCUSS THE TESTIMONY OF**
5 **DR. DENNIS GOINS, WHO SUGGESTS THAT THE**
6 **COMMISSION REJECT SCE&G'S PROPOSED INCENTIVE**
7 **RATE OF RETURN, CONTENDING THAT THE RETURN IS**
8 **TOO HIGH, IS ASYMMETRICAL, AND IS UNNECESSARY.**
9 **WHAT IS YOUR RESPONSE TO HIS TESTIMONY?**

10 A. Largely for the reasons set forth above, I generally disagree with
11 Dr. Goins's statement. I believe that the ROE adder is consistent with
12 and authorized by the statutory language regarding incentives and will
13 serve to encourage investment in cost effective DSM programs. I also
14 believe that, for the reasons I have previously explained, the ROE adder
15 should not be tied to performance measurement goals. It also is my
16 opinion that if the DSM programs and costs are annually reviewed by the
17 Commission and the implementation of these programs is monitored by
18 SCE&G, ORS, the Commission, and other interested parties, the purpose
19 of the DSM programs will be accomplished.

20 I do note, however, that at the end of Item 3 on Page 7 of his
21 testimony, Dr. Goins states that "if the Commission determines that a
22 rate-of-return incentive is appropriate, then I recommend initially setting

1 the incentive no higher than 100 basis points above SCE&G's allowed
2 return on equity." In short, despite Dr. Goins's stated objections to the
3 ROE adder, he nevertheless accepts the concept of the adder, and subject
4 to certain conditions, he is willing to entertain an ROE adder in excess of
5 100 basis points.

6
7 **Q. DR. GOINS ALSO CRITICIZES THE COMPANY'S PROPOSAL**
8 **TO INCLUDE BOTH AN INCENTIVE RATE OF RETURN AND**
9 **LOST MARGIN RECOVERY AS PART OF ITS DSM**
10 **PROGRAMS. WHAT IS YOUR RESPONSE TO THAT?**

11 A. I disagree with his assertions. There is no problem, theoretical or
12 otherwise, with including provisions for both lost margin recovery and
13 an ROE adder as part of the Company's DSM programs. The lost margin
14 revenue, in furtherance of the statutory policies, ensures that the
15 Company is not financially disadvantaged by investing in DSM
16 programs, while the ROE adder provides the Company with an incentive
17 to make the investments. Without lost margin revenue, the Company
18 cannot earn its full cost of service, and without the ROE adder, the
19 Company does not have a clear incentive to invest in DSM programs
20 versus physical generation facilities. In sum, it is appropriate to permit a
21 utility to recover both an ROE incentive and its lost margin recovery in

1 order to ensure that the implementation of DSM programs does not
2 result in financially adverse consequences to the Company.

3

4 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

5 A. Yes.